MainStay MacKay New York Tax Free Opportunities Fund Class I MNOIX

Analysis

New York investors have an intrepid option here.
By Alaina Bompiedi 9/27/2018

The fund's below-average price tag makes it a compelling option, but some aggressive flairs make it far from a conservative choice.

MainStay MacKay New York Tax Free Opportunities utilizes many of the distinctive trades found across this team's muni lineup, but tailored to a smaller investment universe of New York and territory bonds. While that approach has heightened volatility, the fund's strong long-term returns, tenured team, and competitive fees support a Morningstar Analyst Rating of Bronze.

A tenured group of six managers drives this fund's process. Co-CIOs John Loffredo and Bob DiMella head up the broad muni effort with the help of four comanagers, who each have their own muni sector specializations. Mike Petty acts as this fund's lead manager and also heads up MainStay High Yield Municipal Bond MMHAX and the high-yield sleeve in MainStay California Opportunities MSCAX. The managers have worked together since the 1990s, first at Merrill Lynch Investment Management and eventually at MacKay Shields, after Loffredo and DiMella were recruited to revamp MainStay's muni fund offerings in 2009 and the others followed.

This team's views of relative value in the muni market drive the fund's broad positioning, which is reinforced by the bottom-up research of the team's credit analysts. As of July 2018, the fund held a relatively bold overweighting in long-dated munis versus the muni New York long Morningstar Category, which was coupled with a 6% short hedge in 10-year Treasury futures. Additionally, the fund held a nearly 5% position in Puerto Rico bonds. Given the low level of yields in recent years, the team has sought to add yield to the portfolio by investing in high-yield munis (up to 20%), which constituted about 9% of the portfolio at the end of July 2018. These levers give the fund some octane, reflected in its standout performance and above-average volatility. From its 2012 inception through August 2018, the fund's 4.5% annualized return outpaced 17 of its 18 distinct peers in its category; its standard deviation was also one of the highest during that same period.

Process Pillar: Positive

This team plies the same valuation-driven approach here as at MainStay MacKay Tax Free Bond MTBAX and MainStay MacKay High Yield Muni MMHAX, but adjusted for its smaller universe of New York and territory bonds. Unlike more-staid peers, this fund has the flexibility to invest up to 20% in high-yield fare, hold closed-end funds, and utilize Treasury futures. This team has been thoughtful in how it uses these tools, earning the fund a Positive Process Pillar rating.

The fund's constrained universe limits which of this team's annual macro themes (compiled each January) make it into the portfolio. Yet its valuation-aware process still leaves a distinctive mark and can lead to some bold out-of-benchmark positions. For example, the team makes active use of its ability to hedge long-dated bonds with 10-year Treasury futures and has been a prolific buyer of insurance-wrapped fare, including insured Puerto Rico bonds. Both positions introduce risks: Its Treasury hedge introduces basis risk between Treasury futures and munis, and its Puerto Rico position--though predominantly insured--leaves the fund vulnerable to price volatility associated with the commonwealth's credits. The team's valuation discipline informs its maneuvering in these riskier parts of the market, and careful bottom-up credit selection rounds out the remainder of the portfolio.

As of July 2018, the team wasn't using the fund's ability to hold up to 20% in high-yield fare to full capacity. At that point, its stake in below-investment-grade bonds stood at about 10%--double that of the category average. Its position in less-liquid nonrated bonds, however, was above average though not especially large in absolute terms (8% versus the category's 5.5%). Territory debt

Morningstar's Take

Morningstar Analyst Rating	Bronze

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Neutral
Price	Positive

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

Gold | Silver | Bronze | Neutral | Negative

Fund Performance

	Total Return %	+/- Category
YTD	0.56	-0.12
2018	2.17	1.06
2017	5.83	1.35
2016	0.52	-0.05
2015	4.73	1.62

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comprised about 12% of the portfolio, a mix of insured and uninsured Puerto Rico (4%), Guam (6%), and Virgin Islands bonds (2%). While single-state muni funds tend to hold more territories than national funds--owing to a combination of their exemption from both federal and state income tax and higher yields, as well as limited issuance within certain states--that figure still ranks high compared with the broad universe of all single-state funds. Coupled with a relatively sizable 8% short position in 10-year Treasury futures, implemented to offset a larger allocation to long-maturity bonds than its typical peer, the fund had the 13th-highest SEC yield (2.9%) among all funds in long-maturity muni categories at the end of August 2018, a testament to its willingness to court more risk.

Performance Pillar: Positive

Since the fund's inception in June 2012 through August 2018, its trailing annualized return of nearly 4.5% ranked in the best decile of the muni New York long category. It also beat the Bloomberg Barclays Municipal New York Index by 160 basis points. On a volatility-adjusted basis, as measured by Sharpe ratio, the fund's since-inception return was best in its category, supporting a Positive Performance Pillar rating.

In the nearly 10 years following the financial crisis, low yields have mostly rewarded risk-takers, helping high-yield muni funds outpace their higher-quality peers. This fund, with its ability to hold up to 20% in below-investment-grade securities, has taken full advantage by adding credit-sensitive sectors such as higher-coupon territory and tobacco bonds. Those biases have mostly supported the fund's performance as high-yield spreads have narrowed, yet have also weighed on returns during muni sell-offs such as the fourth quarter of 2016, when its 4.4% loss landed at the bottom of its category. While the team was trimming back the fund's high-yield stake as of July 2018, its historical willingness to court more credit risk than average has made the fund more volatile than most in its category.

Strong long-term performance punctuated by sharp moments of credit-driven underperformance illustrates some of the risks inherent in this team's approach.

People Pillar: Positive

MainStay's muni effort is overseen by co-CIOs John Loffredo and Bob DiMella of MacKay Shields, subadvisor to MainStay's lineup of muni funds. The two joined the firm in 2009 to help revive the performance of the firm's laggard MainStay Tax Free Bond fund MTBAX and expand its muni fund offerings. While building out their team at MainStay, Loffredo and DiMella recruited a number of their former colleagues at Merrill Lynch Investment Management, where they had managed funds since the 1990s up until MLIM's 2006 acquisition by BlackRock. Other team members were hired during the pair's brief run at their own firm, Mariner Municipal Managers, from 2007 to 2009. Among them was this fund's lead manager, Mike Petty, a former portfolio manager at Dreyfus who was hired to oversee the team's high-yield muni investments. Petty oversees management of this fund and MainStay MacKay High Yield Municipal Bond MMHAX. This fund's experienced backing earns it a Positive People Pillar rating.

As lead portfolio manager, Petty is responsible for allocating the fund's assets across muni bond sectors and ensuring that the fund takes appropriate risks. Like the other managers here, Petty relies on the credit research of the team's five analysts as background for his valuation calls and positioning decisions. Dedicated trader John Lawler and risk analyst Joanna Ng round out the effort.

Parent Pillar: Neutral

MainStay is the retail investment brand of New York Life Investment Management, itself the asset-management arm of insurance company New York Life. MainStay's expansive mutual fund lineup is managed by NYLIM's investment professionals and subsidiaries, including fixed-income specialist MacKay Shields, global equity shop Candriam, Australian equity group Ausbil, and more recently, U.S. exchange-traded fund specialist IndexIQ. NYLIM also uses subadvisors, such as Epoch and Winslow, the latter of which runs MainStay's largest offering, MainStay Large Cap Growth. NYLIM has grown mostly through acquisitions and distribution partnerships.

NYLIM's boutiques tout that the parent allows them to operate with autonomy. In 2017, MacKay Shields Municipal Managers--one of the stronger boutiques under the NYLIM umbrella--was able to open a second office in Los Angeles to serve its growing base of California clients.

Yet, NYLIM's track record as a parent has some blemishes. The firm acquired long-short equity manager Marketfield in 2012, whose flagship fund, MainStay Marketfield, swelled to over $20 billion in assets by 2014, partly because of a strong sales push from MainStay. Asset bloat impeded performance, and the firms ended their relationship in early 2016. And while NYLIM grants its boutiques some independence, it merged Cornerstone into MacKay Shields in 2018. Overall, MainStay earns a Neutral Parent rating.

Price Pillar: Positive

Most of the fund's assets sit in share classes with relatively cheap fees in their peer group's respective distribution channels, which earns the fund a Positive Price Pillar rating. Just more than half of the fund's assets sit in its retail A share class, whose 0.76% fee is 4 basis points lower than the average front-load muni long fund (excluding certain investment-related costs). Its level-load C share and institutional I share classes also have fees that are solidly below the medians of their respective distribution groups of muni long funds.

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MainStay MacKay New York Tax Free Opportunities Fund — Class A and Class I Shares

Standardized Performance (Period ended 12/31/18)

Symbol (Inception)	1 year	3 years	5 years	Since Inception[1]
Class A (NAV) MNOAX (5/14/12)	1.91%	2.56%	5.34%	3.99%
Class A (max 4.5% load) MNOAX (5/14/12)	-2.67	1.00	4.38	3.27
Class I (no load) MNOIX (5/14/12)	2.17	2.82	5.61	4.25

Total annual operating expenses are: Class A: 0.84% and Class I: 0.59%. Net annual operating expenses are: Class A: 0.76% and Class I: 0.51%.

Returns represent past performance which is no guarantee of future results. Current performance may be lower or higher. Investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost. Performance reflects a contractual fee waiver and/or expense limitation and management fee waiver agreements in effect through 2/28/19, without which total returns may have been lower. These agreements renew automatically for one-year terms unless written notice is provided prior to the start of the next term or upon approval of the Board. Visit mainstayinvestments.com for the most recent month end performance.

The Bloomberg Barclays New York Municipal Bond Index is a market value-weighted index of New York investment-grade, tax-exempt, fixed-rate municipal bonds with maturities of one year or more. An investment cannot be made directly into an index. Past performance is no guarantee of future results.

Credit Ratings: S&P rates borrowers on a scale from AAA to D. AAA through BBB represent investment grade, while BB through D represent non-investment grade.

Duration, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates.

The Morningstar Analyst Rating™ is not a credit or risk rating. It is a subjective evaluation performed by Morningstar's manager research group, which consists of various Morningstar, Inc. subsidiaries ("Manager Research Group"). In the United States, that subsidiary is Morningstar Research Services LLC, which is registered with and governed by the U.S. Securities and Exchange Commission. The Manager Research Group evaluates funds based on five key pillars, which are process, performance, people, parent, and price. The Manager Research Group uses this five pillar evaluation to determine how they believe funds are likely to perform relative to a benchmark, or in the case of exchange-traded funds and index mutual funds, a relevant peer group, over the long term on a risk-adjusted basis. They consider quantitative and qualitative factors in their research, and the weight of each pillar may vary. The Analyst Rating scale is Gold, Silver, Bronze, Neutral, and Negative. A Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group's conviction in a fund's prospects for outperformance. Analyst Ratings ultimately reflect the Manager Research Group's overall assessment, are overseen by an Analyst Rating Committee, and are continuously monitored and reevaluated at least every 14 months. For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to global.morningstar.com/managerdisclosures/.

The Morningstar Analyst Rating (i) should not be used as the sole basis in evaluating a fund, (ii) involves unknown risks and uncertainties which may cause Analyst expectations not to occur or to differ significantly from what they expected, and (iii) should not be considered an offer or solicitation to buy or sell the fund.

Morningstar Analyst Rating Spectrum: *Gold:* Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. *Silver:* Fund with notable advantages across several, but perhaps not all, of the five pillars—strengths that give the analysts a high level of conviction. *Bronze:* Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating. *Neutral:* Fund that isn't likely to deliver standout returns but also isn't likely to significantly underperform, according to the analysts. *Negative:* Fund that has at least one flaw likely to significantly hamper future performance and that is considered by analysts an inferior offering to its peers.

Before You Invest:

Before considering an investment in the Fund, you should understand that you could lose money.

Municipal bond risks include the ability of the issuer to repay the obligation, the relative lack of information about certain issuers, and the possibility of future tax and legislative changes, which could affect the market for and value of municipal securities.

A portion of the Fund's income may be subject to state and local taxes or the alternative minimum tax. Income from municipal bonds held by the Fund could be declared taxable because of unfavorable changes in tax law, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. High-yield municipal bonds may be subject to increased liquidity risk as compared to other high-yield debt securities. The Fund may invest in derivatives, which may increase the volatility of the Fund's NAV. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner.

Because the Fund invests primarily in municipal bonds issued by or on behalf of the State of New York and its political subdivisions, agencies, and instrumentalities, events in New York are likely to affect the Fund's investments and performance. These events may include fiscal or political policy changes, tax base erosion, and state constitutional limits on tax increases, budget deficits, and other financial difficulties. New York may experience financial difficulties due to the economic environment. Any deterioration of New York's fiscal situation and economic situation of its municipalities could cause greater volatility and increase the risk of investing in New York.

1. Average annual total returns include the change in share price and reinvestment of dividends and capital gain distributions. Class I shares are generally only available to corporate and institutional investors.

For more information about MainStay Funds®, call 800-624-6782 for a prospectus or summary prospectus. Investors are asked to consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus or summary prospectus contains this and other information about the investment company. Please read the prospectus or summary prospectus carefully before investing.

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